TO: House Republican Members
FR: Eric Cantor, Republican Whip
DT: February 20, 2009
RE: Administration's Foreclosure Plan

The following memo outlines the major components of the foreclosure plan announced by the Administration yesterday and includes key questions about each component. In evaluating this and other proposals, it may be helpful to keep in mind the following key principles:

Key Principles for Evaluating Any Proposal:

- Responsible homeowners, many of whom are struggling themselves to pay escalating property taxes, should not be saddled with the costs--either through tax increases or higher future interest rates--of rewarding bad behavior on the part of banks or borrowers.
- While we should assist homeowners who find themselves distressed through no fault of their own, taxpayers should not subsidize those who misrepresented their income or assets or who knew they could never have afforded the home they purchased.
- Taxpayers should not subsidize banks and servicers for modifying loans they never should have made.
- We should not expand already failed Fannie Mae and Freddie Mac with taxpayer funds without insisting on real reforms to protect the long-term interest of taxpayers. Above all, we should not be encouraging the same policies that led to the housing collapse fueled by sub-prime mortgages.

Major Components of the "Homeowner Affordability and Stability Plan" Announced by the Administration

Cost to the Taxpayer:

- $75 Billion for the "Homeowner Stability Initiative"
- $200 Billion line of credit from the Treasury to Fannie Mae and Freddie Mac

1. Refinancing Through Fannie Mae and Freddie Mac for Homeowners Who Are "Underwater"

- Currently, homeowners with a debt-to-equity ratio above 80% are not eligible to refinance (and benefit from lower interest rates) through Fannie and Freddie.
- Many of these homeowners are "underwater" because of falling home values, although others may be underwater because they put little to nothing down, or because they withdrew their equity.
- The Administration proposes to allow homeowners to refinance through Fannie and Freddie even if they have a loan-to-value ratio of between 80% and 105%.
- The Administration will also expand the portfolio limit for Fannie Mae and Freddie Mac by $50 Billion and increase their individual line of credit to the Treasury by $100 billion to $200 billion each.

Key Questions:

- Because Fannie Mae and Freddie Mac were "too big to fail" the government had to take them over and provide them with access to taxpayer funds. If this program relies on expanding Fannie Mae and Freddie Mac ever further, what long-term reforms will accompany this plan to protect taxpayers?
- Will homeowners who put nothing down or withdrew all their equity also be eligible for refinancing?

2. Loan Modifications for Those Who Are Behind on Their Mortgages

- Under the plan, if you are behind on your mortgage or at risk at falling behind, you can receive a loan modification whereby if your lender reduces your monthly payments to 38% of your income, then the government will split 50/50 the cost of a further reduction all the way down to 31%. The modification can include reducing interest rates all the way to 2% and a reduction in principal.
- For borrowers who are already behind, loan servicers receive from the government $1,000 up front for the loan modification and $1,000 a year for three years if the borrower remains current.
- If the borrower is not yet behind, but deemed to be at risk of falling behind, the servicer receives from the government an additional $500 and the mortgage holder $1,500 if they proceed with modifying the loan.
- If after the loan modification, the borrower remains current, he or she receives from the government $1,000 a year for five years to reduce the principal on their mortgage.
- If a loan modification cannot be made, the proposal states that "Lenders will receive incentives to take alternatives to foreclosures, like short sales or taking of deeds in lieu of foreclosure."

The Administration provides an example of a homeowner who might benefit:

<u>Family C: Eligible for Homeowner Stability Initiative</u>

- **In 2006**: Family C took out a 30-year subprime mortgage of $220,000, on a house worth $230,000 at the time (they put less than 5% down). Their mortgage broker – Mom & Pop Mortgage – sold their loan to Investment Bank. The interest rate on their mortgage is 7.5%.

- **Today**: Family C has $214,016 remaining on their mortgage but their home value has fallen -18% to $189,000. Also, in November, one parent in Family C was moved from full-time to part-time work, causing a significant negative shock to their income.

    - *<u>Their loan is now 113% the value of their home,</u>* making them "underwater" and unable to sell their house.

    - *Meanwhile, their monthly mortgage payment is $1,538 and their monthly income has fallen to $3,650, meaning <u>the ratio of their monthly mortgage debt to income is 42%.</u>*

- **Under the Homeowner Stability Initiative:** Family C can get a government sponsored modification that – for five years – will reduce their mortgage payment by $406 a month. After those five years, Family C's mortgage payment will adjust upward at a moderate, phased-in level.

	Existing Mortgage	**Loan Modification**
Balance	$213,431	$213,431
Remaining Years	27	27
Interest Rate	7.50%	4.42%
Monthly Payment	$1,538	$1,132
Savings:	***$406 per month, $4,870 per year***	

A quick calculation reveals the government costs for this loan modification (assuming the borrower remains current for five years):

	Annual	**Total Over 5 Yrs**
Payment to Lender for Lowering Interest Rates	$1,530	$7,650
Payment to Lower Borrower's Principal	$1,000	$5,000
Payment to Servicer for Modification	$1,000	$4,000
GRAND TOTAL	**$3,530**	**$16,650**

According to the Administration's plan, the Homeowner in Example C would save $4,870 per year or $24,350 over five years. The taxpayers would spend $16,650 (or 68%) to achieve those savings.

The figures above assume the family was already behind on the mortgage. If they are current on their mortgage and their mortgage holder and servicer identify the family for early modification, the servicer will receive an extra $500, and the mortgage holder will receive an additional $1,500. This brings the total taxpayers' contribution to $18,650 or 77% of the total savings for the family.

Key Questions:

- Why are taxpayers providing a $5,000 bonus to individuals who are only able to remain current on their mortgage after receiving a taxpayer subsidized modification? How is this fair to the millions of homeowners who, through prudent planning, do not fall behind? (Note: assuming that 3.5 million homeowners benefit from this program and that 80% remain current, this bonus payment would cost taxpayers $14 billion)
- Are the subsidies for mortgage holders and the continued subsidies for servicers really necessary?
- If home values appreciate, will taxpayers have any opportunity to recoup the subsidies that have been provided?
- Will individuals who misrepresented their income or worth on their mortgage application be eligible for a taxpayer subsidized mortgage modification?

3. Loan Modification Through Bankruptcy Proceedings

- The Administration's proposal includes the "cram-down" provision being advanced by congressional Democrats like Barney Frank.
- The Administration describes their proposal as follows:

> ***Allowing Judicial Modifications of Home Mortgages During Bankruptcy for Borrowers Who Have Run Out of Options:*** The Obama administration will seek careful changes to personal bankruptcy provisions so that bankruptcy judges can modify mortgages written in the past few years when families run out of other options.
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> ***How Judicial Modification Works:*** When an individual enters personal bankruptcy proceedings, his mortgage loans in excess of the current value of his property will now be treated as unsecured. This will allow a bankruptcy judge to develop an affordable plan for the homeowner to continue making payments. To receive judicial modifications in bankruptcy, homeowners must first ask their servicers/lenders for a modification and certify that they have complied with reasonable requests from the servicer to provide essential information. *This provision will apply only to existing mortgages under Fannie Mae and Freddie Mac conforming loan limits, so that millionaire homes don't clog the bankruptcy courts.*

Key Questions:

- Will interest rates go up as a result of the uncertainty caused by allowing judges to arbitrarily modify loans?